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IN THE

Supreme Court of the United States

October Term, 1951.
No. 237

A. BRIGHAM ROSE and ZELLETTA ROSE; LORI, LTD., INCORPORATED; ZELLETTA M. ROSE and A. BRIGHAM ROSE,
Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

GEORGE T. ALTMAN,
612 South Flower Street,
Los Angeles 17, California,
Counsel for Petitioners.

Parker & Company, Law Printers, Los Angeles. Phone MA. 6-9171.

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Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Petition for a Writ of Certiorari to the United States Court of Appeals for the Ninth Circuit.

Petitioners pray that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Ninth Circuit, entered in the above-entitled case on April 12, 1951.

Opinions Below.

The memorandum findings of fact and opinion of the Tax Court is reported in 8 TCM 8. The opinion of the Court of Appeals is reported in 188 F. (2d) 355.

Jurisdiction.

The judgment of the Court of Appeals was entered on April 12, 1951. [R. 575.] A petition for rehearing filed on May 5, 1951, was denied on May 17, 1951. [R. 576.] The jurisdiction of this Court is invoked under I. R. C., Section 1141(a), and 28 U. S. C., Section 1254(1).

Questions Presented.

1. Whether net worth and income figures shown by financial statements of a taxpayer, where such figures include large amounts of accounts receivable, can be applied in connection with determination of his net income on a cash basis without first eliminating the accounts receivable.

2. Whether such financial statements, correctly construed, are not binding on the government, where they were introduced into evidence by the government, over the taxpayer's objections on the grounds of incompetence and immateriality, and without any limitation on the purpose of their introduction.

3. Whether income from property in respect to which a corporation is a mere nominee or titleholder, an individual being the beneficial owner, is taxable to the corporation or to the individual.

4. Whether the individual in such case is taxable on the rental value of a part of such property occupied by him.

5. Whether in a computation of excess profits taxes under Tax Court Rule 50, effect may not be given to an "excess profits credit," mathematically determinable from the income figures found by the court, merely because such credit was not, as a separate item, claimed in the pleadings.

6. Whether a corporation is not entitled, in the computation of its income and excess profits taxes, to deduction for operating expenses of the corporation paid by an individual out of funds received by him from the corporation.

7. Whether any of the questions above is a question of fact or a question of law.

Statutes Involved.

Several statutory provisions are involved in the matters here considered, especially sections 22(a), 23(a), 41, 42, 43, and 293(b) of the Revenue Act of 1938 and the Internal Revenue Code, and also sections 713 and 1112 of the Internal Revenue Code. However, the questions raised here are not questions of construction of those provisions. For that reason, no statutory provisions are cited or quoted herein.

Statement of the Case.

For the sake of brevity and clarity, the facts specially pertaining to each ground for certiorari are stated under that ground. In order to avoid duplication, those facts are omitted here. As a result, this statement of the case contains only general facts and a skeleton of the case as a whole.

This proceeding involves income and excess profits taxes for the years 1938 to 1941, inclusive. Petitioners A. Brigham Rose and Zelletta Rose are husband and wife. [R. 428.] They came to California in 1927, at which time Rose was admitted to the bar. [R. 429.] Since that time he has engaged in the practice of law in Los Angeles. [R. 429.]

Petitioner Lori, Ltd., Incorporated is a California corporation organized in 1935. [R. 428.] Although it was authorized by its charter to engage in general business activities [R. 428], the record shows only that it held title to certain real estate, known as the "Villa-Courts" [R. 433], and that there was a bank account in its name. [R. 431.] During the period herein involved Rose was

president and treasurer of Lori, and owned two of its six issued shares. [R. 428.]

There were also three bank accounts in Rose's name. [R. 430.] The Commissioner recomputed Rose's net income on the basis of deposits in the accounts in his name, plus withdrawals from the Lori account. [R. 438-439.] He made allowances for certain expenses and certain non-income deposits. [R. 438-440.] The Tax Court adopted the Commissioner's method but made additional allowances for expenses and non-income deposits. [R. 440-441.] The Tax Court did the same in the case of Lori, on the basis of the deposits in the Lori account. [R. 445-447.]

At the trial, respondent introduced into evidence certain financial statements of Rose. [R. 89-91.] Those statements, however, included large and rapidly increasing amounts of accounts receivable, whereas Rose was on a cash basis. [~~Exh. S.~~; R. 428.] Including the accounts receivable, those statements support the Tax Court's determinations. [R. 577; ~~Exh. S.~~] Excluding the accounts receivable, however, they confirm the taxpayers' returns. [R. 526, 527, 506, 13, 529, 508; ~~Exh. S.~~]*

The Tax Court's findings set forth the totals shown in these statements without eliminating the accounts receivable. [R. 444; ~~Exh. S.~~] The Tax Court heavily relied upon these statements, especially in connection with the charge of fraud. [R. 450-451.]

Petitioners sought in the court below to hold that these statements, correctly construed and applied by eliminating the accounts receivable, were binding upon respondent.

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*A comparison of the figures is given *infra*, page 11.

At least, they sought to have the case remanded to the Tax Court so that the said statements, as so corrected, could be given proper weight. There was also the question whether, under the facts as found by the Tax Court, Lori was a mere nominee or titleholder, so that the income appearing in its name was taxable to Rose instead of Lori. Additional matters of lesser importance raised there are indicated herein in the questions presented, and specification of errors to be urged. The court below classified all of these matters as matters of fact, and decided simply that the Tax Court's findings were supported by the evidence. [R. 575.]

Specification of Errors to Be Urged.

The Court of Appeals erred:

1. In failing to hold that, Rose being on a cash basis, the net worth and income figures set forth in the Tax Court's findings, as derived from financial statements of Rose, must be corrected by excluding the amounts of accounts receivable and accounts payable reflected therein.

2. In failing to hold that the said figures, as so corrected, are binding upon respondent and must be given effect in the determination of the net income of Rose and his wife for the years involved.

3. In failing to remand the case to the Tax Court in order to enable that court to give proper weight to the said figures, as so corrected.

4. In failing to hold that the income from the Villa Courts was taxable to Rose, and not to Lori.

5. In failing to hold that Lori had no net income of its own at all.

6. In failing to hold that Rose was not taxable on the rental value of the part of the Villa Courts occupied by him.

7. In failing to remand the case to the Tax Court to enable that court to exclude from income large additional non-income deposits shown by the record.

8. In failing to hold that Rose was taxable on only his community one-half of his professional income for 1938.

9. In failing to hold that in the computation of excess profits taxes under Tax Court Rule 50, allowance should have been made for an excess profits credit, based upon the income of Lori as redetermined for the years 1938 and 1939.

10. In failing to hold that Lori was entitled to a deduction for the expenses of Lori paid by Rose out of funds received by him from Lori.

11. In failing to hold that the evidence was insufficient to sustain the Tax Court's finding of fraud.

12. In failing to hold that the basis of the stocks acquired by Rose as a fee and sold by him at a loss in 1941 was fair market value at the date of acquisition, and that the Tax Court should have made a determination of such value.

13. In failing to hold that the Tax Court should have determined some allowance for depreciation on the Villa Courts based on the mortgages to which said property was subject.

14. In affirming the decision of the Tax Court.

REASONS FOR GRANTING THE WRIT.

I.

The Decision of the Court Below in Upholding the Tax Court's Inclusion of Accounts Receivable in Connection With a Determination of Net Income on a Cash Basis, Is in Conflict With the Decisions of Courts of Appeals of Other Circuits and, Also, With Decisions of This Court.

The returns filed by Rose and his wife for the four years involved showed total net income for those years of approximately $38,000. [R. 526, 527, 506, 13, 529, 508.] The Commissioner, dissatisfied with those returns, as well as Rose's records, for each year added up the deposits in the bank accounts in Rose's name, plus certain items allegedly not deposited, and most of the withdrawals in the account in Lori's name, then made some deductions for expenses and clearly identified non-income deposits, and treated the result, aggregating approximately $117,000 for the four years, as the net income of Rose and his wife for those years. [R. 438-439, 526, 527, 506, 13, 509, 508.] In the Tax Court other expenses and non-income deposits, totaling about $37,000, were proved to the Court's satisfaction. [R. 440-441.] These the Court deducted from the Commissioner's totals, and in that manner redetermined the net income of Rose and his wife for the four years at an aggregate of approximately $80,000. [R. 577.]

By way of confirming the results so arrived at, and supporting a determination of fraud, the Tax Court set forth at length in its findings the totals of assets, net worth and annual income of Rose "during the period involved" [R. 451], as shown by statements of financial condition dated

6-11-38, 4-29-39, 3-1-40, and 9-21-42, respectively, which Rose submitted to his bank. [R. 444, 450-451.] The said totals set forth in the findings, however, included accounts receivable and accounts payable [~~Exh. S~~; R. 444]; whereas Rose reported his income for tax purposes on a cash basis. [R. 428.] During the period so involved the accounts receivable increased from $6,200 to $50,000, or $43,800. The accounts payable were in nominal amounts, decreasing during the same period from $300 to $100, or $200 [~~Exh. S, statements contained therein dated 6-11-38 and 9-21-42, respectively~~]. The increase for the said period of the accounts receivable less accounts payable was, therefore, $44,000. The effect of what the Tax Court did, then, in the application which it made of the financial statements, was to assume that Rose was taxable twice on income totaling $44,000, first in the years in which accrued, and again in the years in which collected.

The use made by Rose of the cash basis for tax purposes and the accrual basis for credit purposes is, of course, not uncommon, nor in the slightest improper. (*Spring City Foundry v. Commissioner,* 292 U. S. 182, 189 (1934); *Commissioner v. Phipps,* 336 U. S. 410, 420 (1949); *Weiss v. Wiener,* 279 U. S. 333, 335 (1929).)*

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*See also "Differences in Net Income for Accounting and Federal Income Taxes," by Clarence F. Reimer; "Tax Acounting Compared with Recognized Accounting Principles," by Paul D. Seghers, National Tax Journal, Volume I, No. 4, December, 1948; "Tax Accounting vs. Commercial Accounting," by J. K. Lasser and Maurice E. Peloubet, Tax Law Review, Vol. 4, No. 3, March, 1949, page 343.

What the Tax Court could have done here in order to convert the financial statements to a cash basis was simply to eliminate the accounts receivable and accounts payable.

In upholding the Tax Court's failure to do so the court below stands in conflict with decisions of other courts of appeals and decisions of this Court. Thus, in *William Hardy, Inc. v. Commissioner* (C. A. 2), 82 F. 2d 249 (1936), involving a change from the cash to the accrual basis the Court of Appeals for the Second Circuit, holding that adjustments must be made in going from one basis to the other, stated, at page 251:

> "They [the accounts receivable] were not taxable on a cash basis. . . ."

To the same effect, *National Bank of South Carolina v. Lucas* (App. D. C.), 36 F. 2d 1013, 1014 (1929).

Again, in *U. S. v. Mitchell,* 271 U. S. 9 (1926), this Court ruled that only actual receipts and disbursements may be given effect. To the same effect, *Avery v. Commissioner,* 292 U. S. 210 (1934); *Burnet v. Logan,* 283 U. S. 404 (1931). And in *Spring City Foundry Co. v. Commissioner,* 292 U. S. 182 (1933), this Court held that accounts receivable and accounts payable signify the accrual basis, not the cash basis.

It follows that in respect to that point the decision of the court below is directly in conflict with decisions of other courts of appeals and decisions of this Court.

II.

The Failure of the Court Below to Treat the Said Financial Statements of Petitioner Rose, Correctly Construed, as Binding Upon Respondent Is in Conflict With General, Long-established Principles, Recognized in a Decision of the Court of Appeals for the Fifth Circuit.

These financial statements of petitioner Rose were offered in evidence by respondent and without any limitation as to the purpose of their introduction. [R. 89-90.] Petitioners objected to their introduction, especially on the ground that each of the statements did not "pertain or relate to the matter of any income *received* by any of the Petitioners herein." [R. 90-91; italics added.] Rose and his wife had filed their returns on a cash basis. [R. 428.] These financial statements were, nevertheless, admitted in evidence. [R. 91.]

Petitioners do not here, and did not in the court below, allege error because of the admission of the said statements of financial condition in evidence; for those statements, *when adjusted to a cash basis, the basis on which the petitioners filed their returns,* sustain the petitioners instead of respondent. What appears in the Tax Court's findings as an increase in net worth of $75,000 during the period involved [R. 444, 450-451], is reduced to only $31,000 by excluding the increase of $44,000 in accounts receivable less accounts payable. [~~Exh. S.~~ R. 572, 585] The same is true of the income amounts shown. The following figures,

covering the net income of Rose and his wife for the four-year period as variously determined, speak for themselves:

As redetermined by the Tax Court from the totals of bank deposits [R. 577]	$79,540.06	
As shown by the returns filed [R. 526, 527, 506, 13, 529, 508]		$37,706.61
As shown by the Tax Court's findings on the basis of Rose's financial statements [R. 444]	$85,300.00	
Same after excluding income accrued but not received of $44,000		$41,300.00*

It is obvious then that if said financial statements are binding on respondent, the Tax Court's redeterminations of the net income of Rose and his wife necessarily fall.

It is the general rule, followed also by the federal courts, that a party introducing a document in evidence is bound by its recitals for all purposes. (32 C. J. S., sec. 1040(d); 20 Am. Jur., Sec. 915.) Nor is a document consisting of a declaration of a party an exception to this rule, where, as here, the document was introduced by the adverse party. (3 Jones on Evidence, Fourth Edition, sec. 236.)

The Court of Appeals for the Fifth Circuit, in a tax case, clearly recognized this rule. In *Snell Isle v. Commissioner* (C. A. 5), 90 F. 2d 481 (1937), that Court said, at page 482, in respect to the taxpayer's return introduced into evidence by the government:

> "It is the general rule that a party, introducing a document in evidence, is bound by its recitals for all purposes. But this rule does not apply where a docu-

*The same result very closely is reached by adding to the $31,000 increase in net worth on a cash basis, Rose's level of nondeductible personal expenses during the period involved as shown by Exhibit S. This is the common net worth method. *Kenney v. Commissioner* (C. A. 5), 111 F. 2d 374 (1940).

ment is introduced for the purpose of impeaching it on the ground of fraud."

The respondent did not introduce the financial statements involved here for the purpose of impeaching them, nor under any other limitation of purpose. [R. 89-91.] The Tax Court, on the contrary, relied on them as showing Rose's income and increase in net worth for the period involved. [R. 444, 450-451.] It follows that, under the general rule, recognized by the Court of Appeals for the Fifth Circuit, these financial statements, correctly construed, are binding upon respondent.

III.

The Decision of the Court Below in Upholding the Decision of the Tax Court Treating as Income to Lori the Income From Certain Property in Respect to Which Lori Was a Mere Nominee or Titleholder, the Tax Court Having Found That the Beneficial Owner Was Rose, Is in Direct Conflict With Decisions of the Court of Appeals for the Eighth Circuit.

Lori filed returns showing aggregate net income of $93.85 for the four years involved. [R. 471, 472, 474, 476.] The Commissioner determined the income of Lori by taking the total deposits made in the account in Lori's name, deducting a few items of negligible amount as expenses, and one large deposit representing a fee belonging to Rose. [R. 445.] Thereby he arrived at net income aggregating approximately $81,000 for the four years involved. [R. 445.] In the Tax Court the Commissioner conceded the non-income character as to Lori of several deposit items aggregating about $24,000, [R. 446], and the Tax Court allowed exclusion or deduction of several other items totaling about $20,000. [R. 447.] By this

process of elimination the Tax Court arrived at net income for Lori aggregating approximately $39,000 for the four years. [R. 577.] It may be noted here incidentally that most of this amount was also indirectly included in the income of Rose as withdrawals from the Lori account. [*Supra,* p. 4; R. 439, 46, 526, 528, 14, 530.]

The only two assets shown by the record to be held by Lori or in Lori's name were a property known as the "Villa Courts" and the Lori bank account. As to the Villa Courts, the Tax Court found that title was in Lori, but that the beneficial owner was Rose. [R. 433.] A mortgage was placed on the Villa Courts by Lori in 1941, but this the Tax Court found was pursuant to a contract whereby Rose agreed to cause Lori to place such mortgage on the property in order to secure *his personal obligation* to one Mary Allen. [R. 433-434.]

The same situation was true also of the Lori bank account. The Tax Court found that that account was used by Rose "for his personal deposits and expenditures" [R. 431], and that during "all years material in these proceedings" Rose had "unrestricted use of all of the funds passing through" that account. [R. 435.] As the Tax Court also found, all that those funds did was pass through that account; none were accumulated there. [R. 445.] In 1938, indeed, a loan of $7,000 was made from the bank, and $5,271.39 thereof was deposited in the Lori account. [R. 446.] But, as the Tax Court found, that loan was not made just to Lori but to all of the petitioners [R. 446, 127]; and it was part of a series of loans which Rose made for his own personal requirements because of the deficiency in his income. [R. 125-127.] Nowhere in the Tax Court's findings, nor anywhere else in the record,

is there anything whatever indicating that Lori engaged in any venture for its own corporate purposes.

The Tax Court, nevertheless, treated the deposits in the Lori account, including the income from the Villa Courts [R. 446-447], as the income of Lori. These results the Court below upheld.

The Court of Appeals for the Eighth Circuit has held, however, that where a corporation is simply the agent, fiduciary or alter ego of another person, or merely the conduit of funds of another person, such corporation is not taxable on the income in respect to which it stands in that relation. *Central Life Assur. Society v. Commissioner* (C. A. 8), 51 F. 2d 939 (1931); *Keokuk & Hamilton Bridge, Inc. v. Commissioner* (C. A. 8), 180 F. 2d 58 (1950). In the *Central Life Assurance Society* case, that Court expressly stated, at page 941:

> "While, for purposes of convenience and certainty in collection of such taxes, it is sometimes provided that those who collect income for others shall pay therefrom the taxes thereon, yet a cardinal purpose of the income tax laws is *to tax the income to the person who has the right or beneficial interest therein*, and not to throw the burden upon a mere collector or conduit through whom or which the income passes." (Emphasis added.)

In the *Keokuk* case the same Court stated, at page 64:

> "The petitioner . . . retained no *beneficial ownership* in the estate . . ." (Emphasis added);

and

> "We conclude that it did not during the years in question receive any income in which it had a *beneficial interest*." Emphasis added.)

The decision of the court below is in clear conflict with the above holdings of the Eighth Circuit.

IV.

The Manner in Which This Proceeding Was Disposed of Below Poses a Grave Question of General Importance in the Administration of Justice.

This point is submitted wholly on principle. The questions involved in the preceding grounds for certiorari were raised in the court below. [Statement of Points, R. 551-552 (pars. 4, 10), 553-554 (par. 15), 557, 559-560.] So were all of the other questions presented herein. [Statement of Points, R. 551-552 (pars. 6, 7, 9).] It would be difficult to imagine that they were abandoned by petitioners in their briefs and in oral argument. One might wonder otherwise why respondent found it necessary in his brief below to cite 102 cases and 21 rules, rulings, and regulations. The opinion of the court below states only, however, that the "matters raised by the briefs and upon oral argument present nothing but questions of fact," and that "the findings of the Tax Court, including the findings of fraud and negligence, are supported by the evidence." [R. 575.]

If cases may be disposed of in this manner, agreement of the circuits, intended as a servant of justice, may become the master instead of the servant, and appellate review may be converted into the arbitrary exercise of the appellate will. Clear questions of law do not necessarily appear on the face of a trial court's findings or opinion. Thus, the question involved in the first ground for certiorari herein, whether accounts receivable may properly be included in a determination of net income on a cash basis, arises only because certain total figures which appear in the findings include accounts receivable, not because the findings *on their face* show that the figures

do. The question, nevertheless, is strictly one of law. All of the cases cited on that question under the first ground for certiorari herein deal with it clearly as a question of law.

This situation is generally true of all of the questions presented herein. While they are all questions of law, they appear only in part or not at all *on the face* of the Tax Court's findings and opinion. If, as here, such questions of law are brought before a court of appeals, and that court renders an opinion which, without stating the questions, disposes of them summarily as questions of fact, it avoids completely any conflict of *published* decisions. Because of this, considering the limited possibility of review in this Court, the important function of the courts of appeals in respect to questions of law can easily be whittled away.

Conclusion.

For the foregoing reasons, this petition for a writ of certiorari should be granted.

Respectfully submitted,

GEORGE T. ALTMAN,
Counsel for Petitioners.

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In the Supreme Court of the United States

OCTOBER TERM, 1951

No. 237

A. BRIGHAM ROSE AND ZELLETTA ROSE; LORI, LTD., INCORPORATED; ZELLETTA M. ROSE AND A. BRIGHAM ROSE, PETITIONERS

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINION BELOW

The memorandum findings of fact and opinion of the Tax Court (R. 426-455) are not officially reported. The *per curiam* opinion of the Court of Appeals (R. 574-575) is reported in 188 F. 2d 355.

JURISDICTION

The judgment of the Court of Appeals was entered on April 12, 1951 (R. 575). The taxpayers' petition for rehearing, filed on May 5, 1951, was denied on May 17, 1951 (R. 576). The petition

for a writ of certiorari was filed on August 13, 1951. The jurisdiction of this Court is invoked under 28 U.S.C., Section 1254.

QUESTION PRESENTED

Whether the court below correctly affirmed the Tax Court's findings that taxpayers understated their income for the taxable years 1938-1941, inclusive, and that the deficiencies in income tax for those years are due to fraud with intent to evade tax.

STATUTES INVOLVED

The applicable statutes are printed in the Appendix, *infra,* pp. 14-16.

STATEMENT

The facts found by the Tax Court may be summarized as follows:

The principal taxpayer, A. Brigham Rose (hereinafter called Rose), has engaged in the practice of law since 1927 and in various business activities beginning in 1931. He and his wife, Zelletta M. Rose, both domiciled in California, filed their income tax returns reporting aggregate net income of $37,706.61 for the four taxable years 1938, 1939, 1940, and 1941 involved. (R. 429-430.)

The third taxpayer, Lori, Ltd., Incorporated (hereinafter called Lori), was a corporation engaged in the business of holding and leasing real estate during the taxable years involved (R. 419, 428). It filed its corporate income tax returns—

but not the requisite excess profits tax returns for 1940 and 1941—reporting total net income of only $93.85 for all taxable years involved (R. 448-449).

During various parts of the taxable years involved, six different bank accounts were carried by a Los Angeles bank, all six of which were used indiscriminately by Rose for his personal deposits and expenditures. These accounts were designated as follows: "A. Brigham Rose, Attorney Account", "Special Account", and "Trustee Account", and "Harry J. Wall, Special Account", "Brevoort Enterprises, Inc.", and "Lori, Ltd., Inc." During the taxable years, the first three named accounts showed aggregate deposits of $103,635 and withdrawals of $103,660, but merely nominal balances at the beginning and end of each year, respectively. (R. 430-431, 434.)

The real estate in which Rose and Lori were interested consists of a hotel structure located in Hollywood, nine bungalows with a dining room known as Villa Courts, located at the rear of and adjoining the hotel, and adjoining property on Vine Street comprising land and three buildings. During the taxable years, legal title to the three properties was held as follows: A lawyer associated with Rose held title to the hotel property, Lori held title to the Villa Courts as trustee for one Mary Allen,[1] and Rose held title to the Vine

[1] The record shows that Mary Allen, also referred to, variously, in the testimony, exhibits and by the Tax Court as "Mary Woods", "Mary Allen-Woods", and/or "Mary Allen

Street property. However, the hotel property and the Villa Courts property were beneficially owned by Rose, subject to the encumbrances against them and an unliquidated claim of Mary Allen against Rose. (R. 431-433.) During all of the taxable years involved, Rose made certain payments to Mary Allen, most of which the Commissioner allowed as deductions (R. 434).

Receipts from the operations of the real properties were deposited in three of the bank accounts heretofore mentioned, and were subject to the unrestricted use of Rose (R. 434-435). Records of the receipts and disbursements showed large net

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Towle" or "Tarol" (R. 73, 115, 118-124, 141, 239, 252, 262, 276, 297-301, 429, 432-433, 443; Ex. 2, 3, 96, HH), was Mary Allen Fuqua, "formerly known as Mary Allen" (R. 359), her maiden name (R. 301). In 1932, Mary Allen was incompetent to handle her own affairs and Rose, as her attorney, drew up a so-called spendthrift trust for her. The securities comprising the corpus of the trust were turned over to the trustee, a business associate of Rose, who was named trustee to serve without bond. In all matters in connection with the trust, Mary Allen acted under the advice of Rose until 1941. Shortly after the creation of the trust, the trustee invested unspecified amounts of the trust funds in the three pieces of property here involved. No accounting was made by the trustee or requested of him by Rose, although Rose was attorney for Mary Allen and was also financially involved in the three properties. The investment of these trust funds in the various properties precipitated the resignation of the trustee in November 1935, after an investigation had been instituted. (R. 432-433.) Upon resignation of the trustee, Rose acquired title to Villa Courts, which he "as trustee" re-conveyed to Lori in 1935 (R. 274-275). In 1938, he appointed himself "trustee" of the Mary Allen trust (R. 434). In 1941, Mary Allen obtained other counsel (R. 238) and brought suit against Rose (R. 360). Her claim against Rose was settled by Rose agreeing to pay her $200 a month during her life, which obligation was to be secured by mortgages covering the hotel and Villa Courts properties (R. 433-434).

income from the properties (R. 434-435). Although Rose personally made some expenditures in behalf of Lori and the hotel and Villa Courts, such expenditures were made by Rose out of funds which he received from Lori, and these expenditures preserved Rose's equities in the various properties (R. 441). The hotel and Villa Courts properties were under lease from February 15, 1939, throughout the taxable years. The rentals, which amounted to approximately $1,200 a month, were available to Rose, due to his control over all of the bank accounts. The rentals were actually credited as follows: To Brevoort Enterprises, Inc. (which operated the hotel during part of the taxable years) from February 15, 1939, to May 2, 1940; from May 2, 1940, throughout the leasehold term, one-third to Lori and two-thirds to the hotel, to which Rose held beneficial title. (R. 435-436.)

Rose was requested by the Commissioner to furnish records from which his income and that of the various corporate entities could be determined. He failed to comply and was required to appear in the local Federal District Court under court order obtained by the Commissioner for the production of such records, but no additional significant information was ever forthcoming. (R. 436.) Rose's analysis of his own bank deposits from 1938 through 1941, showed transfers from Lori's account of over $27,000 and unidentified deposits of over $45,000 (R. 441-442).

In the absence of any records, the Commissioner

determined the taxpayers' income by reference to their reconstructed bank deposits and other evidences of the receipt of income for each of the taxable years involved. The income so determined and attributed to Rose, as set forth in detail in the Tax Court's findings (R. 438-439, 440) is summarized as follows (R. 440):

	1938	1939	1940	1941
Net income per return	none	$3,039.92	$2,636.57	$14,495.10
Net income from profession	8,172.55	8,195.90	3,905.22	(3,643.63)
	$8,172.55	$11,235.82	$6,541.79	$10,851.47
Plus other net income additions	$18,202.17	$6,635.54	$10,474.61	$8,104.18
Net income adjusted per deficiency notices (R. 11–15, 525–531)	$26,374.72	$17,871.36	$17,016.40	$18,955.65

At the hearing in the Tax Court, adjustments were made decreasing the community net income of Rose and his wife in the aggregate sum of $37,505.07 (R. 440-441).

In each of the years 1939 and 1941, taxpayer Rose received substantial fees for his legal services in two cases, neither of which was deposited in his various bank accounts (R. 442). Of the 1939 fee in the amount of $17,500, $6,500 was deposited in Lori's account (R. 227), and the balance was used generally for the payment of a mortgage on the Vine Street property which Rose had acquired (R. 433). The 1941 fee of $26,727 was paid in two checks, one for $10,000 which he cashed at his bank but did not deposit in any of his accounts, while the other for $16,727 was deposited in Lori's account (R. 442).

In addition to cash income, Rose and his wife

received from the operators of the Brevoort Enterprises, Inc., the hotel and the Villa Courts properties, meals having a value of $1,200 during the year 1938, and also living quarters from Lori having a value of $900 a year during 1938 to 1941, inclusive (R. 442-443).

In 1941, Rose sold for $4,140 some stock which he had acquired as a fee from the Mary Allen trust, and claimed a long-term community capital loss of $5,547, one-half each to him and his wife. The Commissioner fixed $4,500 as the basis for the stock, which reduced Rose's long-term capital loss of 50% to $223.50. (R. 443, 508-509.)

Rose and his wife understated in their returns for all taxable years involved the rental income received from the Vine Street property. This resulted from their failure to establish deductible expenses for depreciation applicable to that property in excess of the amounts thereof allowed by the Commissioner. (R. 443-444.) They also failed to include in their income reported for 1938 and 1939 dividends aggregating $720. Finally, upon their failure to substantiate amounts claimed for contributions and a loss from bad debts in the sums of $150 and $460, respectively, for the taxable year 1941, the Commissioner disallowed those items as deductions. (R. 444.)

During each of the years 1938, 1939, 1940, and 1942, Rose submitted statements of his financial condition to the Citizens Bank in which he listed

his assets, net worth and total annual income, as follows (R. 444; Ex. S, R. 579-586):

Date	Assets	Net Worth		Total Income
6-11-38	$119,800.00	$103,000.00		$13,500.00+
4-29-39	140,900.00	124,400.00	In excess of	10,000.00
3-1-40	140,000.00	135,000.00	In excess of	20,000.00
9-21-42	183,900.00	178,000.00		41,800.00

Under these facts, the Tax Court made ultimate findings, upon the record as a whole, that "any" of the deficiencies in tax due from Rose for the taxable years 1938, 1939, and 1941, and from him and his wife for the year 1940, were due to fraud with intent to evade taxes (R. 444, 452).

As to taxpayer Lori, its bank account during the years 1938 to 1941, inclusive, showed gross deposits and withdrawals "per bank ledgers" in the respective amounts of $102,869.20 and $103,098.12, for all four years involved, and like Rose's personal accounts (R. 430-431), it disclosed only nominal balances at the beginning and end of each of those years, respectively (R. 445; Exs. 12, O and JJ).

The Commissioner assumed that the gross deposits in Lori's bank account for the four taxable years involved, less substantiated deductions, represented taxable income to it. Lori's taxable net income, thus adjusted, was thereupon determined by the Commissioner in the deficiency notice in the aggregate sum of $81,039.10 for the four taxable years involved. (R. 445; Ex. P.)

Rose's analysis of Lori's bank deposits for the four taxable years involved identified $40,189.68 as receipts or *presumed* receipts from the hotel and Villa Courts leases, but was unable to identify

other deposits aggregating $12,314.05 (R. 446-447).

In the Tax Court (R. 446-447), the taxpayers established Lori's right to additional adjustments and these were allowed by the Tax Court. The result was to decrease Lori's taxable net income, as originally determined by the Commissioner, in the aggregate sum of $42,179.14. (R. 446-447, 577.)

In these circumstances, the Tax Court likewise found as an ultimate fact, upon all the evidence, that "any" of the deficiencies asserted against Lori for the four taxable years involved are due to fraud with intent to evade taxes (R. 449).

On the basis of the foregoing facts, the Tax Court, sustaining the Commissioner's several determinations in large part for all taxable years involved, found and held that—to the extent redetermined—the amounts of taxable net income in controversy had been properly determined on the bases of the several taxpayers' bank deposits and other evidence of income, and also that the fraud and negligence penalties, as redetermined, were properly asserted by the Commissioner for each taxable year (R. 440-455). The court below affirmed *per curiam* (R. 574-575).

ARGUMENT

Of the many questions it states are presented (Pet. 2), the petition for certiorari discusses but a few, and while those which are discussed are described as legal issues, the Government believes that only factual questions are really presented

on this record. Hence, the court below correctly rested its decision on the findings of the Tax Court, none of which is challenged as clearly erroneous. In these circumstances, there can be no possible basis for certiorari.

1. The decisions below conflict in no way with cases holding that accrual items cannot be charged to a cash basis taxpayer. Although the Tax Court made a finding (R. 444), that on certain dates in 1938, 1939, 1940 and 1942, Rose submitted to a bank statements of his financial condition, in which he listed his assets, net worth, and total income in certain amounts, the Tax Court's determination of Rose's taxable net income for the taxable years was reconstructed from bank deposits and other evidences of income with appropriate adjustments for items that were satisfactorily explained (R. 436-444, 449-450). Its opinion (R. 450-451) merely observes that Rose's financial statements reflected a substantial increase in his net worth, not his taxable income, during the periods involved. Taxpayer has made no showing whatever that the Tax Court included the accounts receivable and accounts payable shown on his financial statements in determining the amount of Rose's taxable net income for the taxable years. It appears, rather, that the Tax Court made its findings as to taxable income after consideration of a maze of confusing and contradictory exhibits introduced by the taxpayers (R. 449-450) and it is not contended that

those findings are clearly erroneous. Hence, the courts below did not hold that accrual items can be charged to a cash basis taxpayer.

2. Nor are the decisions below inconsistent with the dictum in *Snell Isle* v. *Commissioner,* 90 F. 2d 481, 482 (C.A. 5th), that "a party, introducing a document in evidence, is bound by its recitals for all purposes." Petitioners put their case very simply: they say that if the accounts receivable are eliminated from the income shown in the financial statements, those statements sustain them and not the Commissioner (Pet. 10-12). But the matter is not that simple. In the first place, petitioners' returns were filed on a calendar year basis (R. 428); the four financial statements were all dated in midyear. Consequently, even if, on the dates of the financial statements, an adjustment to a cash basis would rebut the Commissioner's claims, there is no showing that what were accounts receivable in June 1948, for example, were not in fact received before the close of the 1948 tax year. Moreover, none of the financial statements attempted to state total income: on the 1938 statement, "total income" was reported as $13,500+ (R. 579); in 1939 and 1940, "total income" was said to be "in excess of" $10,000 and $20,000, respectively (R, 581, 583, 444); and on the 1942 statement, 1941 "business income" was stated to be "over" $40,000 (R. 585). Finally, the last statement Rose submitted to his bank on September 21, 1942 (R. 444), disclosing accounts receivable of

$50,000 *on that date,* does not establish or show *any* accounts receivable for the last taxable year involved here, 1941. It follows that the result reached below in no way contradicts the financial statements introduced by the Commissioner.

3. There is no basis for the taxpayer's assertion (Pet. 12-14) that Lori was erroneously taxed on income from property of which Rose was the beneficial owner. The Tax Court's findings (R. 445-447) show that it took the deposits into, and withdrawals from, Lori's bank account as starting points in determining Lori's income, and that it excluded therefrom all items which were identified by Lori as not representing its income. The remainder only was treated as Lori's income. Since taxpayers have failed to establish any factual basis for excluding any further amounts from Lori's income, they must fail.

Neither the fact that Rose was the person in sole control of Lori's operations and of its bank account (R. 428), nor the fact that, although he had transferred title to Villa Courts to Lori, he remained the beneficial owner thereof (R. 433), is sufficient to compel the Government and the court to disregard the corporate identity of Lori and to treat its income as that of Rose, where Lori was organized to engage in general business activities and during the taxable years it engaged in operating and renting Villa Courts (R. 428, 433, 441). *Moline Properties* v. *Commissioner,* 319 U.S. 436, 438-439. Indeed, having elected to transfer some

of his property into Lori's name and to carry on some of his business in corporate form, Rose may be held to the form elected for tax purposes. *Higgins* v. *Smith,* 308 U.S. 473, 477. Thus, even if the remaining unidentified bank deposits taxed to Lori by the Tax Court had been identified as rentals derived from Villa Courts, this income was properly taxed to Lori.

The facts in *Central Life Assur. Soc. Mut.* v. *Commissioner,* 51 F. 2d 939 (C.A. 8th), and *Keokuk & Hamilton Bridge* v. *Commissioner,* 180 F. 2d 58 (C.A. 8th), did not involve an individual taxpayer and the corporation which he controls, and were very different from those here. Accordingly, whether or not those cases were correctly decided, they are not in conflict with the decision here, contrary to taxpayer's assertion. (Pet. 14.)

CONCLUSION

The decision of the court below is in all respects correct, turns on the particular facts of this case, and presents no conflict. The petition for a writ of certiorari should therefore be denied.

Respectfully submitted,

PHILIP B. PERLMAN,
Solicitor General.
THERON LAMAR CAUDLE,
Assistant Attorney General.
ELLIS N. SLACK,
HELEN GOODNER,
S. DEE HANSON,
Special Assistants to the Attorney General.

SEPTEMBER, 1951.

APPENDIX

Internal Revenue Code:

SEC. 41. GENERAL RULE.

The net income shall be computed upon the basis of the taxpayer's annual accounting period (fiscal year or calendar year, as the case may be) in accordance with the method of accounting regularly employed in keeping the books of such taxpayer; but if no such method of accounting has been so employed, or if the method employed does not clearly reflect the income, the computation shall be made in accordance with such method as in the opinion of the Commissioner does clearly reflect the income. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 41.)

SEC. 45. ALLOCATION OF INCOME AND DEDUCTIONS.

In any case of two or more organizations, trades, or businesses (whether or not incorporated, whether or not organized in the United States, and whether or not affiliated) owned or controlled directly or indirectly by the same interests, the Commissioner is authorized to distribute, apportion, or allocate gross income or deductions between or among such organizations, trades, or businesses, if he determines that such distribution, apportionment, or allocation is necessary in order to prevent evasion of taxes or clearly to reflect the

income of any of such organizations, trades, or businesses.

(26 U.S.C. 1946 ed., Sec. 45.)

SEC. 52. CORPORATION RETURNS.

(a) *Requirement.*—Every corporation subject to taxation under this chapter shall make a return, stating specifically the items of its gross income and the deductions and credits allowed by this chapter and such other information for the purpose of carrying out the provisions of this chapter as the Commissioner with the approval of the Secretary may by regulations prescribe. The return shall be sworn to by the president, vice president, or other principal officer and by the treasurer, assistant treasurer, or chief accounting officer. * * *

* * * * *

(26 U.S.C. 1946 ed., Sec. 52.)

SEC. 54. RECORDS AND SPECIAL RETURNS.

(a) *By Taxpayer.*—Every person liable to any tax imposed by this chapter or for the collection thereof, shall keep such records, render under oath such statements, make such returns, and comply with such rules and regulations, as the Commissioner, with the approval of the Secretary, may from time to time prescribe.

* * * * *

(26 U.S.C. 1946 ed., Sec. 54.)

SEC. 293. ADDITIONS TO THE TAX IN CASE OF DEFICIENCY.

* * * * *

(b) *Fraud.*—If any part of any deficiency is due to fraud with intent to evade tax, then 50 per centum of the total amount of the deficiency (in addition to such deficiency) shall be so assessed, collected, and paid, in lieu of the 50 per centum addition to the tax provided in section 3612 (d)(2).

(26 U.S.C. 1946 ed., Sec. 293.)

The corresponding sections of the Revenue Act of 1938 are substantially the same as the above-quoted provisions of the Internal Revenue Code.

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IN THE

Supreme Court of the United States

October Term, 1951.

No. 237.

A. BRIGHAM ROSE and ZELLETTA ROSE; LORI, LTD., INCORPORATED; ZELLETTA M. ROSE and A. BRIGHAM ROSE,

Petitioners,

vs.

COMMISSIONER OF INTERNAL REVENUE.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

PETITIONERS' REPLY TO RESPONDENT'S BRIEF IN OPPOSITION.

GEORGE T. ALTMAN,
612 South Flower Street,
Los Angeles 17, California,
Attorney for Petitioners.

Parker & Company, Law Printers, Los Angeles. Phone MA. 6-9171.

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PETITIONERS' REPLY TO RESPONDENT'S BRIEF IN OPPOSITION.

I.

Respondent states that none of the findings of the Tax Court is challenged by petitioners as clearly erroneous. (Br. 10.) Petitioners, however, did challenge as clearly erroneous the Tax Court's findings of assets, net worth, and income of Rose based upon financial statements of his without eliminating, since Rose was on a cash basis for tax purposes, the accounts receivable which the statements contained. [R. 444; Pet. 7-9.] The Tax Court directly concluded on the basis of said erroneous findings, and said findings only, that, in respect to the individual

petitioners, there was "a substantial increase in their net worth, *during the period involved.*" [R. 450-451. Italics supplied.] Nowhere in its brief does respondent deny this error in the Tax Court's findings.

II.

Respondent, apparently recognizing the damaging effect of this error, now attempts to escape its effect by denying the materiality of the said financial statements. (Br. 10, 11.) Then why were they introduced by respondent in the first place, and over petitioners' objections on the ground of materiality? And why did the Tax Court set forth in detail the figures, erroneously on an accrual basis, which it took from those statements? [R. 444.]

This contention of respondent, moreover, is based solely upon the fact that the dates of these financial statements were not identical with the closing dates of the taxable years involved here. But the Tax Court treated that variance as insignificant, for, as already observed above, it concluded from those financial statements, and those statements only, that there was a substantial increase in the net worth of the individual petitioners "during the period involved." [R. 450-451.] And if the income figures shown on those statements were not pertinent, then why did the Tax Court set them forth for each year? [R. 444.] And if the fact of increase in net worth was not material, then why did the Tax Court place such stress upon it? [R. 450-451.]

III.

As to Lori, respondent cites *Moline Properties v. Commissioner,* 319 U. S. 436, and *Higgins v. Smith,* 308 U. S. 473. The question in those cases, however, was whether the separate entity of the corporation was to be recognized for tax purposes. There is no such question here. The question here is who was the beneficial owner of the income; and respondent concedes that the beneficial owner was Rose. (Br. 3, 4, 12.) It must follow by respondent's own admission that the decision below is in direct conflict with the decisions of the Eighth Circuit cited and quoted from by petitioners in their petition herein, page 14.

IV.

Respondent makes no attempt to challenge petitioner's fourth ground for certiorari.

Conclusion.

Petitioners do not seek in this court to have the deficiencies asserted against petitioners simply expunged. Petitioners seek only to have the cause remanded to the Tax Court for reconsideration of the record under correct principles of law. This, they submit, is required by respondent's own brief.

GEORGE T. ALTMAN,
Attorney for Petitioners.

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COMMISSIONER OF INTERNAL REVENUE.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT.

PETITION FOR REHEARING.

GEORGE T. ALTMAN,
612 South Flower Street,
Los Angeles 17, California,
Counsel for Petitioners.

Parker & Company, Law Printers, Los Angeles. Phone MA. 6-9171.

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COMMISSIONER OF INTERNAL REVENUE.

PETITION FOR REHEARING.

Petitioners, as a basis for this Petition for Rehearing, submit that respondent, in his brief before this Court, has admitted error with respect to a factor which exceeds in amount the entire sum in dispute. Petitioners further submit that by reason of this, the decision of the Court of Appeals herein is in conflict with long-settled decisions of this Court.

I.

Respondent, in his brief in opposition to the petition for certiorari herein, has taken the position that certain financial statements which they themselves introduced are irrelevant. (Br. p. 11.) The only serious basis given for this position is that the statements "were all dated in mid-

year," while the petitioner's tax returns were filed on a calendar year basis. (Br. p. 11.) Respondent does not defend the Tax Court's inclusion of accounts receivable in the net worth and income figures found as derived from these financial statements.

Contrary to the respondent's position before this Court, however, the Tax Court relied squarely upon these financial statements in its decision below, and the context of its use can leave no doubt that they exercised a strong influence upon the findings of that court. The court stated:

> "With reference to the individual petitioners, there should further be observed a substantial increase in their net worth, during the period involved, as reflected in the statements of financial condition prepared by petitioner. The falsification of such statements is a crime under California law. California Penal Code, Section 532a." [R. 450-451.]

Thus, the language of the decision below in the Tax Court clearly indicates its use of these financial statements, not only as a basis for a deficiency finding, but even more important, as a basis for a finding of fraud. Indeed, the Tax Court is careful to note that its finding of fraud was based "upon the record *as a whole.*" [Br. 8; R. 452.] (Italics added.)

These statements, therefore, played a vital role in the findings of the Tax Court; yet the increase in the accounts receivable contained in the statements and which the Tax Court erroneously failed to remove, some $44,000,

exceeded *the entire amount of income in dispute.* Clearly, then, the error was reversible:

> "An erroneous ruling which relates to the substantial rights of a party is ground for reversal unless it *affirmatively* appears from the whole record that it was not prejudicial." (*McCandless v. United States,* 298 U. S. 342, 347.) (Italics in original text.)

The Court of Appeals did not say, nor does respondent's brief contain any contention, that it affirmatively appears from the whole record that the Tax Court's error was not prejudicial. Nor could it make such a contention here, where the Tax Court not only determined that there was additional income, but found petitioners guilty of fraud; for on that issue, as the Tax Court itself conceded, the burden of proof is on the government, and the evidence "must be clear and convincing." [R. 451.]

II.

The error which the Tax Court made in respect to the financial statements is easy to correct. It is a matter of simple arithmetic to convert financial statements prepared on an accrual basis to a cash basis by eliminating the accruals, here the accounts receivable. It is likewise simple, in the case of an operating business, to convert financial statements dated in midyear to a calendar-year basis by the common process of interpolation. That is what the Tax Court must have done here when, as the quotation above from its opinion shows, it treated the financial statements as showing the increase in petitioners' net worth

"during the period involved." The only error it made in respect to these statements was that it failed to eliminate the accounts receivable. That error, it appears clear, the respondent has conceded.

Petitioners do not seek a new trial. Nor do they seek a simple reversal. All they seek is a remand of the cause to the Tax Court for reconsideration of the record after eliminating the accounts receivable, and any other accruals, from the figures shown in the findings as derived from petitioners' financial statements.

Conclusion.

For the reasons set forth above and in the petition for writ of certiorari, it is respectfully urged that rehearing be granted and that, upon such rehearing, a writ of certiorari issue to the Court of Appeals for the Ninth Circuit.

Respectfully submitted,

GEORGE T. ALTMAN,

Counsel for Petitioners.

Certificate of Counsel.

I hereby certify that the foregoing petition for rehearing is presented in good faith and not for delay and is restricted to grounds specified in Rule 33 of the Rules of this Court.

GEORGE T. ALTMAN,
Counsel for Petitioners.